to the mortgagor, provided that all obligations to HUD have been met.

**§ 242.15 Limitation on refinancing existing indebtedness.**

(a) Some existing capital debt may be refinanced with the proceeds of a section 242-insured loan; however, the hard costs of construction and equipment must represent at least 20 percent of the total mortgage amount.

(b) In the case of a loan insured under Section 242/223(f), there is no requirement for hard costs. However, if there are hard costs, such costs must total less than 20 percent of the total mortgage amount.

[78 FR 8341, Feb. 5, 2013]

## Subpart B—Application Procedures and Commitments

**§ 242.16 Applications.**

(a) *Application process*—(1) *Market need*. The approval process entails a determination of the market need of the proposal and stresses, on a market-wide basis, the impact of the proposed facility on, and its relationship to, other health care facilities and services (particularly other hospitals with mortgages insured under this part and hospitals that have a disproportionate share of Medicaid and uninsured patients or provide a substantial amount of charity care); the number and percentage of any excess beds; and demographic projections. Generally, Section 242 insurance may support start-up hospitals or major expansions of existing hospitals only if existing hospital capacity or services are clearly not adequate to meet the needs of the population in the service area.

(i) If the state has an official procedure for determining need for hospitals, HUD shall require that such procedure be followed before the application for insurance is submitted, and that the application document that need has also been established under that procedure.

(ii) The following factors are relevant in evaluating market need for the project and should be addressed, as applicable, in the study of market need and feasibility submitted with the application. Because each hospital presents a unique situation, there is no formula or cutoff level that applies to all applications:

(A) Service area definition;

(B) Existing or proposed hospital;

(C) Designation as sole community provider, Critical Access Hospital, or rural referral center;

(D) Community-wide use rates (discharges and days/1000);

(E) Statewide use rates (for benchmarking purposes);

(F) Current population and 5-year projection by age cohort;

(G) Staffed versus licensed beds;

(H) Applicant hospital's occupancy rate;

(I) Competitors' occupancy rates;

(J) Outpatient volume;

(K) Availability of emergency services;

(L) Teaching hospital status;

(M) Services offered by hospitals in the service area;

(N) Migration of patients out of the service area;

(O) Planned construction at other facilities in the region;

(P) Historical market share by major service category;

(Q) Disproportionate Share Hospital designation; and

(R) Distance to other hospitals.

(2) *Operating margin and debt service coverage ratio*. (i) Hospitals with an aggregate operating margin of less than 0.00 when calculated from the three most recent annual audited financial statements are not eligible for Section 242 insurance, unless HUD determines, based on the financial data in those statements, that the hospital has achieved a financial turnaround resulting in a positive operating margin in the most recent year, calculated using classifications of items as operating or non-operating in accordance with guidance that shall be provided in written directives by HUD. In any event, HUD shall not issue an insurance commitment for any hospital in a turnaround situation that has not achieved 2 consecutive years of positive operating margin immediately prior to issuance of the commitment.

(ii) Hospitals with an average debt service coverage ratio of less than 1.25 in the 3 most recent audited years are not eligible for Section 242 insurance, unless HUD determines, based on the audited financial data, that the hospital has achieved a financial turnaround resulting in a debt service coverage ratio of at least 1.4 in the most recent year. In cases of refinancing at a lower interest rate, HUD may authorize the use of the projected debt service requirement in lieu of the historical debt service in calculating the debt service coverage ratios for each of the prior 3 years. In cases where HUD authorizes the use of the projected debt service requirement in lieu of the historical debt service to determine the debt service coverage ratio, hospitals must have an average debt service coverage ratio of 1.4 or greater.

(3) *Threshold requirements—refinancing candidates*. For an application to be considered for refinancing pursuant to Section 223(f), a hospital must meet the following requirements in lieu of those described in paragraph (a)(2) of this section:

(i) The hospital must have an aggregate operating margin and average debt service coverage ratio as follows:

(A) The hospital must have an aggregate operating margin of at least zero percent, when calculated from the three most recent annual audited financial statements.

(B) The hospital must have an average debt service coverage ratio of at least 1.4 when calculated from the three most recent annual audited financial statements; or

(ii) If the requirements of paragraphs (a)(3)(i)(A) and/or (B) of this section are not satisfied, HUD will recast the operating margin and debt service coverage ratio for prior periods by applying its estimate of the projected interest rate at the time the mortgage is expected to close in lieu of the historical interest rate(s).

(iii) In performing the calculations called for in paragraphs (a)(3)(i)(A) and (B) of this section, if HUD finds that performance in one of the three years was affected by exceptional, one-time events that substantially altered financial performance, HUD may calculate the three-year performance based on the four most recent years with the unusual year omitted.

(iv) The hospital must document that it provides an essential healthcare service to the community in which it operates and that its financial performance would be materially improved by refinancing its existing capital debt.

(v) The hospital may show that it provides an essential healthcare service to the community in which it operates by submitting an analysis quantifying how the community in which it presently operates would suffer from inadequate access to an essential healthcare service that the hospital presently provides if the hospital were no longer in operation.

(vi) The hospital may show that its financial performance would be materially improved by providing documentation of the following:

(A) There are limited comparable affordable refinancing vehicles available to the hospital; and,

(B) The hospital meets three of the following seven criteria:

(*1*) The proposed refinancing would reduce the hospital's total operating expenses by at least 0.25 percent;

(*2*) The interest rate of the proposed refinancing would be at least 0.5 percentage points less than the interest rate on the debt to be refinanced;

(*3*) The interest rate on the debt that the hospital proposes to refinance has increased by at least one percentage point at any time since January 1, 2008, or is very likely to increase by at least one percentage within one year of the date of application;

(*4*) The hospital's annual total debt service is in excess of 3.4 percent of total operating revenues, based on its most recent audited financial statement;

(*5*) The hospital has experienced a withdrawal or expiration of its credit enhancement facility, or the lender providing its credit enhancement facility has been downgraded, or the hospital can demonstrate that one of these events is imminent;

(*6*) The hospital is party to bond covenants that are substantially more restrictive than the Section 242 mortgage covenants; and

(*7*) There are other circumstances that demonstrate that the hospital's financial performance would be materially improved by refinancing its existing capital debt.

(4) *Financial feasibility*. The approval process entails a determination of the financial feasibility of the proposal, i.e., a determination that it is probable that the proposed mortgagor will be able to meet its debt service requirements during the period projected. It includes analysis of the reimbursement structure of the proposed hospital (including patient/payer mix); actions of competitors; and the probable projected impact on the proposed hospital of general health care system trends, such as the development of alternative health care delivery systems and new reimbursement methods. In addition to historical operating margin, determination of financial feasibility includes, but is not limited to, evaluation of the following factors, which the application must address and which HUD will review:

(i) Current and projected gains from operations and a manageable debt load using reasonable assumptions;

(ii) Current debt service coverage ratio of 1.25 or higher and projected debt service coverage ratio of 1.40 or higher;

(iii) Cushion in the balance sheet sufficient to demonstrate the ability to withstand short periods of net operating losses without jeopardizing financial viability;

(iv) Patient utilization forecasts (including average length of stay, case intensity, discharges, area-wide use rates) that are consistent with the hospital's historical trends, future service mix, market trends, population forecasts, and business climate;

(v) The hospital's demonstrated ability to position itself to compete in its marketplace;

(vi) Organizational affiliations or relationships that help optimize financial, clinical, and operational performance;

(vii) Management's demonstrated ability to operate effectively and efficiently, and to develop effective strategies for addressing problem areas;

(viii) Systems in place to monitor hospital operations, revenues, and costs accurately and in a timely manner;

(ix) A Board that is appropriately constituted and provides effective oversight;

(x) Required licensures and approvals; and

(xi) Favorable ratings from the Joint Commission on Accreditation of Healthcare Organizations or other organizations acceptable to HUD.

(5) *Preliminary Review*. A Preliminary Review is a general overview of the acceptability of a potential mortgagor performed at the request of a hospital, a financial consultant representing a hospital, or a lender, to identify any factors that would likely cause an application to be rejected, should an application be submitted.

(i) The purpose of the preliminary review is for HUD to identify any obvious factors that would cause an application to be rejected, before the potential mortgagor or mortgagee expends resources to prepare one. The hospital, financial consultant, or lender shall submit a preliminary information package to HUD that provides evidence of statutory eligibility, market need, financial strength, and such other documentation as HUD may require. The scope of the preliminary review does not include approval of any specific site in the community.

(ii) If HUD identifies factors that would cause an application to be rejected, HUD shall issue a Preliminary Review Letter notifying the potential applicant that an application for mortgage insurance would probably not be successful and providing the reasons for this decision. Also, no further request from the proposed applicant for a Preliminary Review shall be entertained for a period of one year from the date of HUD's notification. HUD may grant an exception to this one-year limitation if, during the year, there is a major change in the circumstances that caused HUD to determine that the project would be rejected. For example, if the sole reason for HUD's determination was the hospital's failure to meet the historical operating margin test, and a new audited annual financial statement contains results that would cause the hospital to meet the test, then the lender may request a new Preliminary Review within one year of HUD's notification.

(iii) If HUD does not identify any factors that would cause an application to be rejected, HUD shall issue a Preliminary Review Letter advising the potential applicant that there appears to be no bar to the applicant's proceeding to the next step in the application process, provided that if a complete application is not received by HUD within one year following the date of HUD's letter, another Preliminary Review may be required, at HUD's discretion, before the application process may proceed.

(iv) The Commissioner's determination in the preliminary review phase that no factors have been identified that would cause an application to be rejected shall in no way be construed as an indication that a subsequent application will be approved.

(6) *Preapplication meeting*. The next step in the application process is the preapplication meeting (this step is optional, at HUD's discretion, in Section 242/223(f) cases). At HUD's discretion, this meeting may be held at HUD Headquarters in Washington, DC, or at another site agreeable to HUD and the potential applicant. The preapplication meeting is an opportunity for the potential mortgagor to summarize the proposed project and refinancing, if any; for HUD to summarize the application process; and for issues that could affect the eligibility or underwriting of the project to be identified and discussed to the extent possible. Following the meeting, HUD may:

(i) Advise the potential applicant that there appears to be no bar to submitting an application for mortgage insurance; or

(ii) Identify issues that must be resolved before a full application should be submitted for processing.

(b) *Application contents*. The application for mortgage insurance shall include exhibits that follow such guidance as to content and format that HUD shall provide from time to time. The application shall include:

(1) A description of the proposed sources and uses of funds;

(2) A description of the mortgagor entity, its ownership structure, and its directors and managers;

(3) A description of the project, the business plan of the hospital, and how the project will further that plan, or, for applications pursuant to Section 223(f), a description of any limited rehabilitation to be financed with mortgage proceeds and how that limited rehabilitation will affect the hospital;

(4) Historical audited financial statements and interim year-to-date financial results (for existing hospitals);

(5) A study of market need and financial feasibility, addressing the factors listed in paragraphs (a)(1)(ii) and (a)(2), or (a)(3) of this section, (whichever applies), with assumptions and financial forecast clearly presented. The study should be prepared by a certified public accounting firm acceptable to HUD. In the case of an application for Section 242/223(f) mortgage insurance, the study may not be required to address market need and there may be no requirement for involvement of a certified public accounting firm;

(6) Architectural plans and specifications in sufficient detail to enable a reasonable estimate of cost (not applicable to a Section 242/223(f) application, except when architectural plans and specifications are requested by HUD);

(7) Evidence that the hospital will be located in a state or political subdivision of a state with reasonable minimum standards of licensure and methods of operation for hospitals and satisfactory assurance that such standards will be applied and enforced with respect to the hospital;

(8) If the state has an official procedure for determining need for hospitals, evidence that such procedure has been followed and that need has been established under that procedure;

(9) A Phase I environmental report; and

(10) Such other exhibits as HUD shall require based upon the facts pertaining to the particular case.

(c) *Fee*. An application fee of $1.50 per thousand dollars of the amount of the loan to be insured shall be paid to HUD at the time the application is submitted to HUD for approval.

(d) *Filing of application*. An application for insurance of a mortgage on a project shall be submitted on an approved FHA form, by an approved mortgagee and by the sponsors of such project, to FHA.

(e) *Complete application*. Only technically complete applications will be processed. Partial applications cannot be processed. Upon determination that an application is complete, HUD shall issue a Completeness Letter to the applicant stating that the application is complete.

(f) *Application review.* Upon receipt of a complete application, HUD shall evaluate the application to determine if eligibility, market need, financial feasibility, and compliance with applicable regulations (including but not limited to federal environmental regulations, wage rate regulations, and health care regulations) have been demonstrated, and to evaluate any other factors, including but not limited to risk to the Insurance Fund, that should be considered in determining if the application for mortgage insurance should be approved. As a part of this review, HUD may solicit the advice of private consultants and expert staff in the Department of Health and Human Services and other federal agencies. Based on review of the complete application, HUD may request additional information from the applicant. The timeliness of the applicant's submission of the additional information may affect the approval or disapproval of the application. The Commissioner's decision shall be communicated in the form of a Commitment Letter or a Rejection Letter. HUD will not issue a Commitment Letter until HUD completes the environmental review under 24 CFR 242.79.

[72 FR 67546, Nov. 28, 2007, as amended at 78 FR 8341, Feb. 5, 2013]

### § 242.17 Commitments.

(a) *Issuance of commitment.* Upon approval of an application for insurance, a commitment shall be issued by HUD setting forth the terms and conditions under which an insurance endorsement shall be issued for the hospital. The commitment shall include the following:

(1) A commitment for insurance of advances reflecting the mortgage amount, interest rate, mortgage term, date of commencement of amortization, and other requirements pertaining to the mortgage and construction project;

(2) In the case of an application for Section 242/223(f) insurance where advances are not needed for funding any limited rehabilitation: a commitment for insurance upon completion, reflecting the mortgage amount, interest rate, mortgage term, date of commencement of amortization, and other requirements pertaining to the mortgage and to any limited rehabilitation;

(3) HUD's computation of the replacement cost and maximum insurable mortgage amount;

(4) Financial requirements for closing;

(5) Approval covenants, including any special conditions that must be satisfied prior to initial endorsement;

(6) Mortgage Reserve Fund Agreement.

(b) *Type of commitment.* The commitment will provide for the insurance of advances of mortgage funds during construction. In the case of a commitment for Section 242/223(f) insured refinancing or acquisition financing of an existing hospital, the commitment shall provide for insurance upon completion unless insured advances are needed for funding any limited rehabilitation approved by HUD, in which case the commitment shall provide for insurance of advances.

(c) *Term of commitment.* (1) The initial commitment shall be issued for a period of 90 days.

(2) The term of a commitment may be extended in such manner as HUD may prescribe, provided, however, that the combined term of the original commitment and any extensions do not exceed 180 days.

(d) *Commitment fee.* A commitment fee that, when added to the application fee, will aggregate $3 per thousand dollars of the amount of the loan set forth in the commitment, shall be paid within 30 days of the date of issuance of the commitment. If such fee is not paid within this 30-day period, the commitment shall automatically terminate.

[72 FR 67546, Nov. 28, 2007, as amended at 78 FR 8342, Feb. 5, 2013]

### § 242.18 Inspection fee.

(a) The commitment may provide for the payment of an inspection fee in an amount not to exceed $5 per thousand dollars of the commitment. The inspection fee shall be paid no later than the time of initial endorsement.